

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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August 26, 2009

**LEGEND:**

Taxpayer =

Trust =

State =

Board =

Plan =

Dear :

This is in reply to your letter dated May 20, 2009, and subsequent correspondence, in which you request a ruling on behalf of Taxpayer with respect to Trust.

Taxpayer is a voluntary nonprofit organization each of whose members is the board of education of a city or county in State (Board). Each Board is composed of members who are appointed by the governor of State or by the governor and mayor or are

selected through public elections. Pursuant to State law, each Board has been delegated the power of eminent domain. Each Board is a political subdivision of State.

Taxpayer created Trust as a vehicle to assist participating employers to provide their employees with retiree health insurance benefits. Each participating employer in Trust must be a member of Taxpayer. Most of the trustees of Trust are selected by the participating employers. Each participating employer selects one trustee. In addition, Taxpayer selects one trustee. A trustee can be removed by the selecting party. As a condition for joining Trust, each prospective participating employer must create its own member trust, the income of which is excluded from gross income under §115 of the Internal Revenue Code (the Code). Contributions to Trust are made by a participating employer through its member trust. Trust funds are invested in accordance with investment objectives and policies of the member trusts. Each participating employer has its own retiree health plan (Plan).

The income of Trust consists of contributions made by the participating employers through their member trusts and investment income. Distributions from Trust are made to the participating employer's member trust. Employee and retiree contributions are not permitted. Disbursements from Trust are solely for the purpose of paying for retiree health insurance benefits and trust administration expenses. No part of Trust's net earnings may inure to the benefit of any private person other than the incidental benefit to the Plan participants.

The trustees may amend the trust agreement. In addition, the trustees have the right to terminate Trust at any time for any reason. Upon termination, any assets remaining in Trust will be used for the exclusive benefit of retirees pursuant to the Plans adopted by the participating employers. In no event will assets be transferred to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115(1) of the Code.

#### LAW & ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling

points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to Trust various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to retired employees of its members, all of which are political subdivisions of State. Providing health insurance benefits to retired employees of a political subdivision of a state constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to its members. Upon termination of Trust, its remaining assets will be used to provide health benefits to the retirees of its members pursuant to the Plan adopted by each member. In no case will Trust assets be distributed to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under §115 of the Code.

Based on the information submitted and representations made by Taxpayer, we hold that the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of §115(1). Accordingly, Trust's income is excludable from gross income under §115(1) of the Code.

No opinion is expressed on the classification of Trust as a trust for federal tax purposes. No opinion is expressed concerning the federal tax consequences to Trust under any other provision of the Code other than those specifically cited above. This ruling concerns only the federal tax treatment of Trust's income. No opinion is expressed regarding the treatment of Plans under any section of the Code. In particular, no opinion is expressed concerning the federal tax consequences of contributions to or payments from Plans including (but not limited to) whether amounts are excludable from the gross income of employees, former employees or retirees under §§ 104, 105 or 106 of the Code.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Harry Beker, Chief  
Health and Welfare Branch  
Office of Division Counsel/Associate Chief  
Counsel  
(Tax Exempt & Government Entities)

cc: